



The following constitutes
the order of the court. Signed July 7, 2014

M. Elaine Hammond

M. Elaine Hammond
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re Case No. 12-46534 MEH
Pacific Thomas Corporation, Chapter 11
Debtor. /
Kyle Everett, Adv. No. 13-04079 AH
Plaintiff,
vs.
Randall Whitney, et al.,
Defendants. /

DECISION AFTER TRIAL

In his complaint, Kyle Everett, Chapter 11 Trustee ("Trustee") for Pacific Thomas Corporation ("PTC") sought declaratory relief regarding the validity of the lease agreement between PTC and Pacific Trading Ventures ("PTV"), an accounting, injunctive relief against PTV and individual defendants Randall Whitney ("Whitney") and Jill Worsley ("Worsley"), and turnover of books and records and funds owed to the estate. Subsequently, the court found that, without admitting its

1 validity, the Trustee terminated the lease pursuant to its terms, and
2 also terminated a management agreement for cause. On this basis, the
3 court issued its Preliminary Injunction.¹ The Preliminary Injunction
4 (a) required PTV to turnover all rent or other income received related
5 to PTC property, (b) required PTV, Whitney and Worsley to turn over to
6 the Trustee current and historical books and records related to the PTC
7 property, and (c) restrained Whitney and Worsley from entering the
8 property or interfering with the Trustee's transfer of management and
9 operations of PTC's property from PTV to a new management company. At
10 trial, the remaining issues were the validity of the lease and
11 management agreements, whether such agreements (if valid) were
12 terminated, and the Trustee's request for turnover of pre- and
13 post-petition funds from PTV. If the Trustee prevails, the Trustee
14 will further request that the preliminary injunction be made permanent.
15

16 The court has jurisdiction over this matter pursuant to 28 U.S.C.
17 §§ 157 and 1334. This decision after trial constitutes the court's
18 findings and conclusions pursuant to FRBP 7052.
19

20 Applicable Law

21 At trial, the Trustee asserted claims for declaratory relief and
22 turnover.

23 Declaratory relief requires an actual controversy and that the
24 controversy relate to a matter within federal court subject matter
25

26 ¹ See Docket #76, entered November 18, 2013.

1 jurisdiction. 28 U.S.C. § 2201; *Am. States Ins. Co. v. Kearns*, 15 F.3d
2 142, 143 (9th Cir. 1994). The parties stipulated to this court's
3 jurisdiction in the Joint Pretrial Conference Statement.

4 A finding of an actual case or controversy requires a finding that
5 the case is ripe for adjudication. *Id.* With respect to a dispute
6 sounding in contract, ripeness requires "a substantial controversy,
7 between parties having adverse legal interests, of sufficient immediacy
8 and reality to warrant the issuance of a declaratory judgment."
9 *Principal Life Ins. Co. v. Robinson*, 394 F.3d 665, 671 (9th Cir.
10 2005) (quoting *Maryland Cas. Co. v. Pacific Coal & Oil Co.*, 312 U.S.
11 270, 273 (1941)). The validity of the lease agreement has been
12 disputed since the appointment of the Trustee and must be resolved to
13 allow the Trustee to administer the estate.

14 The Trustee originally sought turnover of books and records and
15 funds he asserts are owed to the estate. Prior orders addressed the
16 defendants' turnover obligations. At trial, the Trustee seeks a
17 judgment against PTV for funds owing to PTC. As stated on the record,
18 the Trustee does not seek a judgment against Whitney or Worsley.
19 Bankruptcy Code² § 541 provides an expansive definition of property of
20 the estate, including all legal or equitable interests of the debtor
21 in property as of the commencement of the case. Bankruptcy Code § 542
22 requires turnover of property of the estate to the Trustee.

23 ////

24 ////

25
26 ² 11 U.S.C. §§ 101, et seq.

Prepetition Management Agreement

In 2003, PTC and PTV entered into a management agreement (the "Management Agreement") for PTV to manage PTC's real property and the self-storage facility located at 2619 East 12th Street in Oakland. The parties agree that PTV managed both the self-storage business and PTV's commercial real properties. As on-going compensation for its services PTV was to receive the greater of \$1,500 per month or 6% of the monthly gross revenues actually collected. PTV was also to be compensated at the rate of 10% of the total project cost for supervision of nonrecurring projects greater than \$1,000 in value. (Art. VI). The Management Agreement further provides that PTV was responsible for collecting rents from tenants (Art. I, F), maintaining records related to disbursements in connection with management of the premises (Art. VIII, I) and hiring and oversight of employees for the self-storage business (Art. I, A). PTV was authorized to purchase materials, supplies, insurance or other services for multiple properties it managed and charge PTC a pro rata share of the cost (Art. I, D).

The Management Agreement was subsequently amended to extend the term and increase PTV's minimum monthly fee to \$2,000 per month.

The parties then entered into a business practice whereby PTV deposited the funds it received from tenants into PTC's accounts upon collection. PTV would receive and record invoices related to the PTC property. PTV would then issue payment and invoice PTC for the funds needed to cover the PTC-related expenses. PTC would promptly transfer the invoiced amounts to PTV. This process continued until PTC's bankruptcy filing.

1 The Trustee does not contest the validity of the Management
2 Agreement prior to its termination.

3
4 Prepetition Lease Agreement

5 Two years after the Management Agreement was initially signed, PTC
6 and PTV signed a lease agreement dated January 1, 2005 (the "Lease
7 Agreement") providing for lease of the self-storage facilities by PTV.
8 The Lease Agreement is signed by Whitney, on behalf of PTC, and
9 Worsley, on behalf of PTC. They each signed an agreement to extend the
10 Lease Agreement for an additional five-year term in 2010 (the "Lease
11 Extension").

12 In addition to the Lease Agreement, PTC and PTV executed a 2008
13 lease agreement for 1,500 square feet of office space, supposedly
14 included in the Lease Agreement. The 2008 lease agreement makes no
15 reference to the prior Lease Agreement.

16 The financial terms of the Lease Agreement are substantially
17 different from the Management Agreement. They provide that PTV will
18 pay to PTC monthly rent of \$2,500, plus the greater of \$22,500 or 40%
19 of the property net operating income on a monthly basis. In essence,
20 the Lease Agreement changes the business operations to make PTV
21 responsible for the self-storage facilities' expenses and then entitles
22 PTV to receive any profits generated from its operation.

23 Despite this supposed upheaval in the business terms between PTC
24 and PTV, their implementation and accounting of PTV's operation of the
25 self-storage facilities were unchanged. As established by the
26 Trustee's evidence:

1 - PTC's QuickBooks for 2005-2011 include the revenues and
2 expenses of the self-storage facility, these records are used to
3 prepare PTC's profit and loss statements reflecting the same
4 information.

5 - PTC's tax returns for 2005 - 2011 include the revenues and
6 expenses of operations related to the self-storage facility.

7 - PTV's QuickBooks for 2005 - 2011 do not include the revenues
8 and expenses of operation related to the self-storage facility.

9 - The Business Tax Certificate for the self-storage facility is
10 in PTC's name.

11 PTV's trial brief and the evidence it presented at trial is
12 consistent. PTV's defense of the Trustee's turnover claim further
13 demonstrates the parties' continued course of conduct under the
14 management fee-plus-reimbursement arrangement set forth in the
15 Management Agreement. PTV's evidence includes all invoices issued by
16 PTV in 2006 and 2007. These invoices show that PTV regularly invoiced
17 PTC for expenses incurred in operation of the safe storage facility,
18 and its fees pursuant to the Management Agreement. Further, PTV's
19 invoices reflect prompt payment of these invoices by PTC.

20 Changes began to occur in 2012. For the first time PTV began to
21 record rental income from the self-storage facility in its QuickBooks
22 records. From January through July 2012, both PTV and PTC recorded the
23 rental income in their QuickBooks. Journal entries in PTV's
24 QuickBooks, posted as of December 31, 2011, seek to shift what was
25 previously PTC revenue onto PTV. The Trustee testified that an audit
26 trail of these journal entries shows these adjustments were entered in

1 late-August 2013, after the bankruptcy was filed.

2 Finally, five days before PTC filed its bankruptcy petition,
3 representatives of PTC and PTV signed an Amendment and Modification to
4 the Lease Agreement (the "Lease Amendment"). The Lease Amendment
5 purported to shift additional responsibility to PTV. Notably, it
6 substantially increased the rent to be paid by PTV to \$70,000 per month
7 and stated PTV "shall continue to be responsible for the operating
8 costs, excepting property taxes, insurance and deferred maintenance."
9 (Para. 1.A.)

10 The evidence presented by the Trustee and PTV establishes that
11 while representatives of PTC and PTV appear to have signed the Lease
12 Agreement in 2005, the companies never complied with its terms or
13 modified the business arrangement between the parties through 2011.
14 During this period, the companies continued to operate pursuant to the
15 Management Agreement. Further, while some transition in business
16 arrangement was attempted during 2012, it was incomplete and
17 ineffective as of the bankruptcy filing.

18 Accordingly, the court finds based on the evidence presented that
19 the parties failed to perform or act as if a lease existed between the
20 parties. On that basis, the Lease Agreement, the Lease Extension and
21 the Lease Amendment were not valid contracts between the parties,
22 particularly where the parties performed in accordance with a
23 different, and conflicting agreement.

24 Further, on February 21, 2013, the Trustee provided notice to PTV
25 of his intent to terminate the Lease Agreement pursuant to its terms,
26 without admitting its validity. The Trustee then provided a second

1 notice on August 30, 2013. Article 2 of the Lease Agreement, as well
2 as Section 13 of the attached provisions, authorizes termination of the
3 lease upon 30 days written notice, with or without cause. The Lease
4 Extension modified the termination provisions by providing: "All other
5 provisions within the original lease agreement shall remain as stated,
6 excepting, of course, the (a) expiration date which is being extended
7 as provided herein, and (b) that thereafter, the lease agreement shall
8 be cancellable only upon either party giving to the other six (6)
9 months written notice of termination." The termination notices
10 provided by the Trustee satisfied both the 30 day and 6 month written
11 notice requirements. Accordingly, the court finds that even if the
12 Lease Agreement as extended or amended was valid, it was terminated
13 pursuant to written notice by the Trustee on behalf of PTV.
14

15 Termination of the Management Agreement

16 Article VII of the Management Agreement provides PTC with the
17 right to terminate the agreement in the event that PTV is in material
18 breach of any term or provision of the Management Agreement and such
19 breach is not cured by PTV within 10 days after delivery of a written
20 notice setting forth the nature of the breach. On August 30, 2013, the
21 Trustee provided PTV with written notice that it was in material breach
22 of the terms of the Management Agreement based upon:

- 23 - PTV's failure to turnover Clark Construction rents for May and
24 June;
25 - PTV's inability to collect and remit Clark Construction rents
26 for July and August;

- 1 - PTV's failure to turnover Performance Contracting, Inc. rents
- 2 since the filing of the petition on August 6, 2012;
- 3 - PTV's failure to turnover Safe Parking and Budget collections
- 4 for the second half of July 2013 and the first half of August
- 5 2013;
- 6 - PTV's failure to turnover Avila Trucking rents for July and
- 7 August 2013; and
- 8 - PTV's failure to turnover Mujeres Unidas Y Activas rents for
- 9 July and August 2013.

10 The breaches identified in the notice were not cured within 10
11 days. Accordingly, the Management Agreement was terminated as of
12 September 10, 2013. For the purposes of calculating fees due pursuant
13 to the Management Agreement, the Trustee assumed a management fee was
14 due through October 2013, as the Preliminary Injunction finding
15 termination and ordering turnover was not entered until November 18,
16 2013.

17
18 Whether funds are due from PTV to PTC

19 In the complaint, Trustee requested turnover of books and records
20 to determine amounts due to PTC from PTV. The Trustee did not receive
21 books and records related to this request. Now, the Trustee seeks
22 judgment against PTV of \$1,278,891 for funds the Trustee asserts are
23 due to PTC.

24 The Trustee bears the burden of persuasion on his claim. Once he
25 establishes the basis of his claim, PTV has the burden of producing
26 evidence to rebut the claim. Fed. R. Evid. 301.

1 The Trustee made the following demand:

2 - Prepetition - Note Receivable - PTV (12/31/11)	\$712,206
3 - Postpetition:	
4 o All Property Rents received by PTV and PTC	\$1,820,920
5 o Less: Rents Paid to PTC	(\$1,116,886)
6 o Less: Payments made on Note Receivable	(\$ 43,138)
7 o Less: Management Fees through 10/14/13	(\$ 109,255)
8 o Plus: PTV Cash Balance (11/18/13)	<u>\$ 15,044</u>
9 o NET Postpetition Due	<u>\$566,685</u>
10 - TOTAL	\$ 1,278,891

11
12 Prepetition Demand

13 The Trustee asserted his claim for the prepetition demand based
14 upon category 1274 on PTC's Balance Sheet Statement for a note
15 receivable due from PTV. This note receivable category is provided for
16 in PTC's records from at least 2006 through 2011 and grew from year to
17 year. The Trustee has not identified a note to support this claim.
18 His claim relies on the information used to generate the balance sheet
19 contained in a QuickBooks version identified as the correct version by
20 PTC's tax accountant, Mr. Brophy. At trial, Mr. Brophy testified that
21 he had never seen a note, and that his tax preparations are based on
22 the information as maintained in PTC's QuickBooks.

23 At trial, PTV established through cross-exam of the Trustee that
24 although PTC's balance sheet showed a note receivable, neither PTV's
25 balance sheet nor its QuickBooks carried a corresponding entry for a
26 note payable. Instead, PTV identified a separate "2200 Due to/from

PTC" category maintained in PTC's QuickBooks. The amounts due at year end 2008, 2009, 2010 and 2011 closely match the PTV notes payable balances on PTC's books for each of these years.³ Mr. Brophy testified that in his work with PTC and PTV the 2200 category represents a transfer of cash between the two entities, generally on the basis of expense reimbursements. The 2200 category would be used by the person entering activity into QuickBooks if they were not sure in what category the entry should be placed. The entries in this "ask Tim" account were to be reviewed and re-categorized later.

Ms. Manning, PTV's bookkeeper for approximately 10 years, credibly testified to financial transactions between PTC and PTV consistent with the Management Agreement. Ms. Manning's duties included maintaining PTV's QuickBooks and preparing invoices. She regularly issued invoices from PTV to PTC for management fees and funds needed from PTC to cover vendor expenses paid by PTV on PTC's behalf. The standard process was that an invoice would be received by PTV from a vendor and entered into PTV's records. Once the vendor was recognized as a vendor for the Oakland facility, an invoice would be issued to PTC for the funds needed to pay the vendor. All of PTV's invoices for 2007 and 2008 were admitted as evidence. These invoices show that most of PTV's invoices were issued to PTC each year. The invoices are for management fees,

³

Year	PTV Note Receivable (Line 1274)	PTC Due to/Due from (category 2200)
2008	\$526,573	\$547,026
2009	\$581,492	\$590,846
2010	\$669,841	\$669,842
2011	\$712,206	\$711,207

1 funds to cover accounts payables and insurance. The invoices are
2 electronically stamped as paid and include the date of payment. Each
3 invoice for funds to cover accounts payables is also listed in the
4 QuickBooks 2200 category report.⁴ As listed in the financial reports
5 filed with PTV's tax returns, these are funds for which PTV owes an
6 obligation to PTC; however, no evidence was presented identifying on
7 what basis an obligation would be due—and further, an obligation from
8 PTV to PTC for these amounts is inconsistent with my finding that the
9 Management Agreement represents the valid agreement and operation
10 between the parties.

11 On the evidence presented, I find that the Trustee's assertion of
12 a note receivable balance is not persuasive. Neither a note nor a
13 basis for a note receivable was identified. PTC's records on this
14 point are limited, and PTV's records do not show a corresponding note
15 payable. Instead, PTV's records identify similar amounts as expenses
16 paid in connection with PTV's management of PTC's self-storage and
17 commercial real property facilities. As such, I find that the Trustee
18 has not established his claim for recovery of a prepetition note
19 receivable.

20
21 Postpetition Demand

22 When PTC filed its chapter 11 case, a significant change in
23 operations occurred. During the postpetition period, PTV collected and
24

25 ⁴ The invoices for management fees are not included in the category
26 2200 QuickBooks account.

1 kept all rents received. It then paid expenses on PTC's behalf and
2 turned over the remaining rents to PTC. This change had two effects.
3 First, as PTC did not collect or turnover all rents due from several
4 commercial property tenants, it led to a default under the Management
5 Agreement, and the Trustee's termination of that agreement for cause.
6 Second, the Trustee disputes whether the postpetition funds paid by PTV
7 on PTC's behalf were valid and appropriate expenses of the estate and
8 asserts a claim for recovery of all rents received, less PTV's
9 management fees. The Trustee asserts a claim for \$566,685 for the
10 difference between postpetition rents received and amounts turned over
11 to PTC as rent or other payments, less the management fees due to PTV
12 postpetition.

13 PTV asserts that the difference is for postpetition business
14 expenses incurred in the ordinary course of business. PTV does not
15 provide any invoices or other support evidence regarding the use of
16 funds.⁵ Instead, it relies on an interim report filed by the Trustee
17 after the Management Agreement was terminated, wherein the Trustee
18 asserts that expenses related to operation of the property are
19 approximately \$40,000 per month.

20 The court finds the Trustee's interim report insufficient to rebut
21 Trustee's evidence in support of a postpetition claim. The Trustee
22

23 ⁵ PTV's introduction of its 2007 through September 30, 2012 bank
24 statements is unavailing. These postpetition statements only cover
25 two months of the postpetition period. Further, the transaction
26 descriptions fail to identify whether a purchase was made for PTC's
business expenses or how purchases made for plane tickets, rental
cars and restaurants are for the benefit of PTC.

1 identifies generally expenses incurred related to operation of the
2 property but does not state the status of payment on such expenses, or
3 whether PTV used rents solely for operating expenses. Further, the
4 Trustee testified that based upon his review of PTV's books and records
5 for this period, PTV made numerous payments from the PTC rents not
6 appropriately expenses of operation. These include payments to
7 professionals not hired by the PTC bankruptcy estate, Hawaii travel and
8 condominium expenses, payment on a judgment against Whitney and
9 insurance and travel reimbursement of Whitney. While it appears PTV
10 applied some portion of the postpetition rents demanded for expenses
11 related to PTC's business, I find the evidence presented insufficient
12 to determine an amount attributable to PTC's expenses. The Trustee
13 established that the postpetition rents received by PTV on behalf of
14 PTC are property of the estate and PTV did not establish an amount to
15 be setoff against PTV's required turnover of estate property.

16
17 Conclusion

18 For the reasons stated herein, the court finds:

19 (1) That the Lease Agreement was signed but never effectuated by
20 PTC and PTV. As a result, enforcement of the Lease Agreement,
21 Lease Extension and Lease Addendum was waived by the parties. If
22 the Lease Agreement was ever valid, it was terminated by the
23 Trustee by notice pursuant to its terms.

24 (2) That the Management Agreement was the agreement by which the
25 parties operated. This agreement was terminated by the Trustee
26 for cause as of August 30, 2013, however, PTV continued to

1 provide services through entry of the Preliminary Injunction.
2 PTV is entitled to receive management fees through October 14,
3 2013 based upon the turnover of operations.

4 (3) A final injunction should be entered consistent with the
5 Preliminary Injunction providing for termination and turnover of
6 PTV's business operations, prohibiting further involvement of
7 Whitney, Worsley and other Restrained Parties (as defined in the
8 Preliminary Injunction) in PTV's current business operations, and
9 such further relief as ordered in the Preliminary Injunction.

10 (4) The Trustee did not establish that PTC's estate is entitled
11 to a judgment of \$712,206 against PTV for a prepetition Note
12 Receivable.

13 (5) The Trustee established, and PTV did not rebut, that PTC's
14 estate is entitled to a judgment of \$566,685 against PTV for
15 postpetition rents received and not turned over to PTC.

16 The Trustee is directed to submit a judgment consistent with this
17 decision.

18 **END OF ORDER**
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COURT SERVICE LIST

All Recipients